UT 96-8
Tax Type: USE TAX
Issue: Machinery & Equipment Exemption - Manufacturing
Use Tax on Purchases, Fixed Assets or Consumables

STATE OF ILLINOIS
DEPARTMENT OF REVENUE
OFFICE OF ADMINISTRATIVE HEARINGS
SPRINGFIELD, ILLINOIS

DEPARTMENT OF REVENUE OF THE STATE OF ILLINOIS	)	
v.	)	**Docket #**
TAXPAYER	)	**IBT #**
Taxpayer	)	

RECOMMENDATION FOR DISPOSITION

APPEARANCES

Mr. Keith Casteel, Samuels, Miller, Schroeder, Jackson & Sly, for TAXPAYER.

SYNOPSIS

This case came on for hearing following a Retailers' Occupation and Use Tax audit performed upon TAXPAYER (formerly known as TAXPAYER, and hereinafter referred to as "taxpayer") by the Illinois Department of Revenue (hereinafter the "Department") for the period of January 1, 1991 through April 30, 1994. Taxpayer agreed to its liability on some audit findings and they are not part of this hearing.

Taxpayer disagrees with the Department's assessment of its purchase of two pieces of heavy equipment, specifically a WA-500 wheel loader and a D135A crawler dozer, and related parts. Also at issue herein is the Department's assessment of taxpayer's purchase of certain lab equipment. The reason for taxpayer's disagreement and protest is its belief the items qualify for the manufacturing machinery and equipment exemption.

The parties entered into certain stipulations according to 86 Ill. Adm. Code, ch. I, Sec. 200.150 and these are incorporated herein.

After reviewing this matter, I recommend the issue be resolved partly in favor of the taxpayer and partly in favor of the Department.

FINDINGS OF FACT

1. Taxpayer conducted business operations near Nokomis, Illinois during the audit period by operating a limestone quarry where it extracted and processed limestone into various product sizes for sale to customers. (Tr. pp. 7 and 8; Dept. Ex. No. 2)
2. Taxpayer's quarrying operation begins with the process of removing overburden soil from the ground that covers the limestone deposit, thereby exposing its underground position in the earth. (Tr. pp. 23-26; Taxpayer Ex. Nos. 1 and 2)
3. The limestone material at the Nokomis quarry must be blasted in order to be removed from its deposit position. The limestone is quite hard and is not amenable to digging out with a drag line, or excavator, or to removal by ripping. (Tr. pp. 87-88)
4. Taxpayer blasts the limestone deposit using explosives placed into drilled holes. The limestone shatters into a pile of fragments known as shot rock or quarry run. The primary purpose of the blast is to fracture and break the deposit so that it is economically feasible for taxpayer to extract it from the earth so that it can be processed in preparation for sale. (Tr. pp. 87-88)
5. After blasting, taxpayer uses the assessed D135A crawler dozer to move the rock into a pile for pick up. The assessed WA-500 wheel loader picks up and moves the shot rock to the vibrating feeder containing a grizzly bar grate system that separates the rock into

different sizes, with the remaining larger pieces being fed into the crusher. (Tr. pp. 31-40; Taxpayer Ex. Nos. 1-5)

6. The rock product is then moved by conveyor belt to the primary screening, or scalping screening unit where the initial four products are made. Rock is then conveyed further to a surge pile for storage or to the plant for further processing. (Tr. pp. 44-45, 65)

7. Taxpayer's operations prior to the rock being processed in the vibrating feeder constitute quarrying and extractive activites. (Tr. pp. 23-40, 65; Taxpayer Ex. Nos. 1-5)

8. The lab equipment at issue was purchased by taxpayer for use in testing to see if its products met government specifications. (Tr. pp. 46-48; Taxpayer Ex. No. 10)

9. Pursuant to statutory authority, the auditor did cause to be issued a Correction and/or Determination of Tax Due (SC-10) and this served as the basis for Notice of Tax Liability (NTL) No. XXXXX issued December 27, 1994 for $37,211, and NTL No. XXXXX issued same date for $578, both inclusive of tax, penalty and interest. (Dept. Ex. Nos. 1, 3 and 4)

10. The introduction of the Department's corrected return and two Notices of Tax Liability into evidence established its *prima facie* case. (Tr. pp. 3, 10; Dept. Ex. Nos. 1, 3 & 4)

CONCLUSIONS OF LAW

Section 3 of the Use Tax Act (35 ILCS 105/3 imposes Use Tax upon the privilege of using in this State tangible personal property, including heavy machinery such as loaders and dozers. Section 3-5 excludes from taxation:

> (18) Manufacturing and assembling machinery and equipment used primarily in the process of manufacturing or assembling tangible personal property for wholesale or retail sale or lease . . " 35 ILCS 105/3-5

Section 3-50 states in part that for purposes of this exemption:

> (1) "Manufacturing process" means the production of an article of tangible personal property, . . . by a procedure commonly regarded as manufacturing, processing, fabricating, or refining that changes some existing material into a material with a different form, use or name. . . " 35 ILCS 105/3-50

While the auditor assessed Use Tax on the disputed items in this case, it is clear that the Department's Retailers' Occupation Tax regulation on this exemption (86 *Ill. Adm. Code,* ch. I, Section 130.330) applies in an analysis of whether items qualify under the Use Tax Act exemption (86 *Ill. Adm. Code,* ch. I, Section 1201), and Section 130.330 (b) (4) states in part:

> (1) . . .The extractive process of quarrying does not constitute manufacturing. However, the activities subsequent to quarrying such as crushing, washing, sizing and blending will constitute manufacturing, and machinery and equipment used primarily therefor will qualify for the exemption, if the process results in the assembling of an article of tangible personal property with a different form, use or name than the material extracted.

Because this regulatory language says that the extractive process of quarrying is not manufacturing, I must find that the dozer and crawler machines used herein do not qualify for the exemption. In writing this recommendation, I am required to make findings of fact based upon competent evidence produced at hearing, and conclusions of law which I can reasonably deduce from such evidence. In so doing, I must remain mindful of Department regulations on the contested issues and I must make my conclusions in accordance with such regulatory provisions and not contravene them as the Department is clearly authorized to promulgate such regulations. 20 ILCS 2505/39b3 and 39b28. As the primary usage of both the WA-500 wheel loader and the D135A crawler dozer is in the extractive process of moving the shot rock to the vibrating feeder/grizzly bar/crusher, I conclude that under the regulation it is not entitled to the exemption.

Taxpayer argues that because the initial blast with explosives involves crushing the limestone into smaller pieces, this blasting action should be considered "crushing." In offering this argument, taxpayer attempts to come within the ambit of the regulatory language authorizing the exemption for crushing activities. l cannot agree with taxpayer's conclusion because the

regulatory language authorizing crushing activities subsequent to quarrying to qualify as manufacturing is conditional upon the process resulting in new tangible personal property ". .with a different form, use or name than the material extracted." (86 *Ill. Adm. Code*, Sec. 130.330 (b)(4)) The new and resulting material must thus be different than the material that was extracted, and the loader and dozer here only move the rock material that is being extracted from the deposit to the vibrating feeder/grizzly bar/crusher configuration, and do not engage in creating a new and different material.

What Section 130.330 does is authorize the exemption for the crusher machinery, but it does not grant the exemption to machinery used in moving the rock from the blast site to the crusher. This is in accord with Section 130.330 (d)(4)(C) that does not exempt equipment or machinery primarily used to move materials prior to their entrance into the production cycle. Here the "manufacturing" production cycle for taxpayer, by regulation, begins with the screening, sorting and crushing activity of the vibrating feeder/grizzly bar/crusher apparatus, and the machinery/equipment used up until that time is involved primarily in the quarrying and extraction process. While the blast certainly causes the limestone to break into smaller pieces, the primary purpose of the blast is to fracture and break the deposit so that it can be economically feasible for a business, such as taxpayer, to extract it from the earth so that it can be processed in preparation for sale. (Tr. pp. 87-88)

Taxpayer argues that because the shot run that is created by its blasting contains salable products, the blast is the initial stage of its "manufacturing process." I do not find this argument persuasive because taxpayer's own witness explained that while some rip rap quarry run can be marketable after the blast, all the other products require further processing in the form of screening and separating before they can be sold, with the first four products created at the primary scalping screening unit after the material has been through the vibrating feeder/grizzly bar/crusher apparatus. (Tr. 44-45, 75)

It is important to remember that the Department amended Section 130.330 (b)(4) to exempt aggregate crushing, washing, sizing and blending activities to acquiesce in and be consistent with the Circuit Court's decision in Macon County Material, Inc. v. Illinois Department of Revenue, 80-TX-10 (6th Judicial Circuit, Circuit Court of Macon County, April, 1982). In that case the court found that equipment used in the Plaintiff's washing, sizing, crushing and blending processes was exempt, but not equipment used prior thereto.

Guidance has been provided in this area by the Illinois Supreme Court in Van's Material Co. v. Department of Revenue, 131 Ill.2d 196, (1989), wherein the court held that redi-mix concrete trucks can qualify for the exemption. In its analysis the court addressed "three distinct words or phrases which form the gist of the Statute" (131 Ill.2d at 203):

(1) tangible personal property
(2) process of the manufacturing or assembling; and
(3) primarily.

Applying these criteria to the instant case, I find regarding number (1) that the ultimate crushed limestone products sold by taxpayer are tangible personal property. Notwithstanding this, taxpayer's machines do not qualify because the other two standards are not met. Concerning the number (3) requirement of primary usage, I note the facts show the primary usage of the loader and dozer at issue, as well as the related assessed parts, is to move the shot rock in the extraction process that occurs after the blast and prior to the manufacturing process involved in the screening, sorting and crushing activity of the vibrating feeder/grizzly bar/crusher apparatus.

The second step (2) of the Supreme Court's analysis in Van's involved the phrase "process of the manufacturing or assembling." The Court noted how sand, limestone, water and cement are combined and mixed together to form the new product of redi-mix concrete. This contrasts to the instant case where the blast only causes the limestone to fracture into smaller pieces of stone, and there is no adding of water, or any other component or material, prior to

blasting the rock that combines and stays with the rock to form a different product.

The Court in Van's reviewed how the Department had historically, in letter rulings and otherwise, treated redi-mix concrete trucks to be engaged in a manufacturing process (131 Ill.2d, at 208-210), and the Court noted that what is *commonly regarded* as manufacturing for the purpose of the exemption is as stated by the legislature in the statutory definition itself, Van's, at 209. I cannot find or conclude that the blasting occurring in this case is commonly regarded as manufacturing as no materials are being mixed with and stay with the rock to form a new material. The only change that occurs at the blast is the fragmentation of the deposit into smaller pieces, and this is an incidental benefit to taxpayer as the blast itself is an indispensable part of the extraction process. (Tr. 87-88) The Illinois General Assembly has distinguished between the business of manufacturing and the business of quarrying, as Section 3 (820 ILCS 305/3) of the Workers' Compensation Act, in listing enterprises or businesses that can be extra hazardous, separates quarrying (category 5) from the manufacture of goods, wares or merchandise (category 16).

I find upon the evidence in this record that the lab equipment purchased by taxpayer qualifies for exemption according to 86 Ill. Adm. Code, ch. I, Sec. 130.330 (d)(3)(C), and I recommend the tax attributable to these purchases be deleted from the appropriate final assessment. Because I conclude the taxpayer has not overcome the *prima facie* case of the Department on the dozer, loader and related parts, I recommend these items remain in the tax base for calculation of the final assessments.

RECOMMENDATION

Based upon my findings and conclusions as stated above, I recommend the Department reduce NTL No. XXXXX and issue a final assessment, and I also recommend the Department finalize NTL No. XXXXX in its entirety.

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Karl W. Betz,
Administrative Law Judge